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SUBJECT: SLOVAKIA: DESPITE CRISIS, NO BUDGET REVISION IN SIGHT

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SUMMARY

¶1. (SBU) Though there has been no formal budget revision since the scale of the economic crisis became clear some six months ago, senior government officials are beginning to admit that Slovakia's budget deficit is likely to reach at least 6 percent this year. Revenues are sharply down, and despite a raft of announcements about specific cuts (reftel), we have seen no solid indication of a comprehensive plan and only slight anecdotal evidence of promised cuts actually being implemented. By the same token, there has been some recent discussion of revenue enhancements but no real plan so far. If oft-repeated statements by PM Robert Fico and his Finance Minister about the importance of a balanced budget are to be believed, it appears that painful cuts may be in store for 2010, an election year, which makes little political sense. It may also be that PM Robert Fico plans simply to defer any serious fiscal planning until after next summer's election and blame the results on the global recession. End summary.

WEAK REVENUES DRIVING 6 PERCENT DEFICIT

¶2. (U) In the face of sharply declining revenues and generally steady expenditures, the GoS appears to be approaching an admission that its deficit for 2009 will substantially exceed the Maastricht ceiling of 3% of GDP. The exact picture is anything but clear, since the government has steadily delayed revising the budget, despite calls from the opposition and at least one coalition partner for a formally presented revision for Parliamentary vote. However, Finance Minister Jan Pociatek recently admitted publicly that analyst estimates of around 6% deficit are realistic. The official budget, which is still based on 6.5% positive growth, forecasts a deficit 1.7%.

¶3. (U) The causes of the higher deficits are routine news in this crisis year: GDP fell at an annual rate of 11.4% in the first quarter of the year, industrial production in May was down nearly 24% year on year, and unemployment has reached a 3-year high of 11%. The slowdown has dramatically lowered government revenues at the same time that it has pushed up social spending. Compared with the same period last year, estimated revenues as of June were down 11.19%, tax revenues were down 13.35%, and VAT revenues were down an astonishing 18% (a drop caused partly by shoppers going to neighboring countries to take advantage of their recently weakened currencies).

SPENDING: "THEY'VE CLOSED THEIR EYES"

¶4. (SBU) On the spending side, the budget contains a 7.35% increase over last year (June to June), though the government has announced since late 2008 a mish-mash of cuts: on local governments, on defense procurements and staffing, on capital spending, and even, most recently, on government purchases of paper. The announcements have been pointedly vague, however, and no comprehensive view of how spending might be cut across the various ministries has been presented. There are rumors of across-the-board cuts of 10-15%, though whether this could be achieved in the one quarter remaining is doubtful at best. In response to our question of how the government is managing spending for the balance of this year, one person close to the Ministry of Finance said simply, "They've closed their eyes." Other sources have told us that line ministries are ramping up spending now in anticipation of cuts in the fourth quarter.

¶5. (SBU) Pociatek has begun speculating publicly about tax hikes to limit the deficit. Again, though, specifics are lacking. He has mentioned raising taxes on gambling and alcohol, and Prime Minister Robert Fico has talked about raising taxes on banks (mainly as a threat against bankers reluctant to cooperate in proposed consumer loan programs). Perhaps the most credible talk-- confined for the moment to the sub-political level of technical experts in the Finance Ministry--is of unifying collections to streamline the administration of personal income taxes and health and social contributions. Such a measure would be a welcome and long overdue broadening of Slovakia's markedly narrow tax and contributions base, and a simplification of a thicket of different assessment bases, ceilings, exclusions, etc. But it can hardly be done overnight, and probably not in time to affect 2010 revenues.

COMMENT: PUZZLING POLITICS

¶6. (SBU) Behind the opacity in the budget situation is the interesting question of why Fico's government is being so cagey. Politically, Fico is on top of the world now. He could easily get Parliament to swallow a revised 2009 budget showing a monstrous deficit--not that 6% is monstrous these days--and simply ignore any criticism from the opposition or the press. He could start the inevitable cuts in government spending now (though that would certainly be procyclical) in order to minimize the pain in 2010, an election year. (Note: Though the GoS has held internal budget cut talks and announced various cuts, both public documents and our sources within government have indicated that very few cuts have been implemented. End note.) He is taking none of these options, and in doing so will make 2010 fiscally more precarious. His finance minister has made a dogma of the notion that tiny Slovakia cannot afford to signal the market that it has lost control over its spending (otherwise markets will demand higher return for the higher risk), and Fico--so far--has consistently preached the doctrine of limited deficits. Pociatek has described the cuts that will be necessary in 2010 as "drastic."

¶7. (SBU) Fico may be planning to hunker down until after the elections, talking as little as possible about budget issues and simply hoping that the average voter won't care about the country's fiscal condition, which he will likely blame on the global recession. He is adamant in declaring that he will not touch social spending, yet he has so far been nearly as insistent on moving toward a balanced budget. The arithmetic doesn't square, but it seems that admitting this, and working on it, is to concede points to the opposition, which owns the fiscal-responsibility message.
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